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BY EMAIL

September 23, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: Halton Hills Hydro Inc.
Application for Approval of a Z-Factor Rate Rider
For Recovery of Ice Storm Related Restoration Costs
Board File Number EB-2014-0211

In accordance with Procedural Order #2, please find attached Board Staff's submission in the above-noted proceeding. Halton Hills Hydro and the intervenors have been copied on this filing.

Halton Hills Hydro's reply to the submission is due on October 7, 2014.

Yours truly,

Original Signed By

Martha McOuat

Encl.

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2014 Z-factor Distribution Rate Application

Halton Hills Hydro Inc.

EB-2014-0211

September 23, 2014

Board Staff Submission
Halton Hills Hydro Inc.
2014 Z-factor Distribution Rate Application
EB-2014-0211

Introduction

Halton Hills Hydro Inc. ("Halton Hills Hydro") filed an application with the Ontario Energy Board seeking approval for the recovery of certain amounts related to the restoration of electricity service in the Town of Halton Hills due to an ice storm in December 2013.

Board staff has reviewed Halton Hills Hydro's application and its responses to interrogatories, and the submissions of Board staff are set out below.

Beginning on the evening of December 20th and continuing through December 21st and 22nd, an ice storm swept across Southern and Eastern Ontario bringing down trees and power lines resulting in extensive damage to electricity distribution systems across the Province. According to its application, Halton Hills Hydro had 21,522 customers, or 100% of its customer base, without power at the height of the ice storm. To aid in restoring power, Halton Hills Hydro obtained the assistance of ten external contractors and eleven electricity distributors. By December 29, all distribution lines had been restored. Remaining work to attach customers requiring repairs to their own equipment prior to reconnecting was completed by January 1.

On March 18, 2014, Halton Hills Hydro sent a letter to the Board notifying the Board of the infrastructure damage caused by the ice storm and Halton Hills Hydro's intention to file a Z-factor claim.

In this Application, Halton Hills Hydro requested the recovery of a total Z-factor claim of $1,561,372, comprised of $1,542, 229 in incremental OM&A costs and $19,143 in carrying costs up until the proposed disposition initiation date of November 1, 2014. Halton Hills Hydro has deemed its capital costs related to the restoration effort as not material and has not included such costs in its claim. Halton Hills Hydro is requesting that the amount be recovered by means of a fixed rate rider across all connections and metered customers based on its customer count on December 31, 2013, for a period of 24 months beginning November 1, 2014 and ending October 31, 2016.

Halton Hills Hydro's summary of the expenses to be recovered is as follows:

Table 1

Summary of Incemental 2013 Ice Storm Costs		
Halton Hills Hydro - Internal Labour		
Overtime	$	245,341.20
Tree Trimming and Contractors	$	868,936.53
Utilities	$	378,269.03
Other External Costs		
Accommodations	$	19,371.10
Communication Costs	$	15,253.13
Fuel	$	9,297.92
Meals	$	5,760.03
	$	1,542,228.95
Accrued Interest to March 31, 2014	$	5,918.40
Accrued Interest from April 1, 2014 to November 1, 2014	$	13,224.61
Total Claim	$	1,561,371.96

Based on the *Board's Report on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*[1] dated July 14, 2008, Z-factors are intended to provide for unforeseen events outside of the control of a distributor's management. The cost to the distributor must be material and its causation clear. In order for amounts to be considered for recovery by way of a Z-factor, the amounts must satisfy the following three eligibility criteria:

- Causation – Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived.

[1] http://www.ontarioenergyboard.ca/oeb/_Documents/EB-2007-0673/Report_of_the_Board_3rd_Generation_20080715.pdf

- Materiality – The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor, otherwise they should be expensed in the normal course and addressed through organizational productivity improvements.

- Prudence – The amounts must have been prudently incurred. This means that the distributor’s decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.

Causation

In response to interrogatories, Halton Hills Hydro confirmed that the costs included in the Z-factor claim are incremental costs and that all regular payroll costs and associated regular vehicle costs were deducted from the total cost claim. Halton Hills Hydro provided a detailed breakdown of regular and overtime hours worked, which clearly demonstrated that the internal labour costs are specifically related to overtime payments over the applicable period.

Halton Hills Hydro’s 2012 cost of service application included an amount for Emergency Maintenance, although the amount approved in that application is unclear. Halton Hills Hydro was asked for this amount in interrogatories from both Board staff and intervenors. Halton Hills responded that the OM&A amount for Emergency Maintenance was $123,766, however, it appears that this is an actual amount rather than an approved budget amount. Further clarification of the approved Emergency Maintenance budget amount is requested of Halton Hills Hydro in its reply submission.

Regardless, Halton Hills Hydro has calculated a 5-year average of Emergency Maintenance OM&A expense of $113,323. Actual Emergency Maintenance expense in 2013 excluding the damage included in this application was $168,911, due to storm damage earlier in the year. Halton Hills Hydro stated that this budget was exhausted by September 2013 and that no further funds were available to apply to the December ice storm.

Board staff submits that the amount requested, subject to the clarification sought above, would appear to be directly related to the Z-factor event. Staff submits that actual expenditures appear to demonstrate that the costs are beyond that which is embedded in its rates. However, staff submits that the optimal method by which the applicant can convincingly demonstrate that the costs are outside of the base upon which its rates were derived is to provide the 2012 budget amount initially requested by both staff and intervenors.

Materiality

Board staff notes that the Board's materiality threshold for a Z-factor claim is $50,000 for a distributor with a distribution revenue requirement less than or equal to $10 million.

In its summary, Halton Hills Hydro noted an approved revenue requirement of $8,821,486 from its 2012 cost-of-service application (EB-2011-0271).

Board staff submits that Halton Hills Hydro's $1,561,372 total cost claim is material.

Prudence

Halton Hills Hydro confirmed that it follows a rotating three-year tree trimming cycle.

In response to interrogatories, Halton Hills Hydro filed a copy of its Emergency Preparedness Plan and confirmed that the plan supersedes its purchasing policy. The Emergency Preparedness Plan was followed in its response to the December 2013 ice storm.

Halton Hills Hydro reported in its application that it confirmed the availability of certain known contractors prior to the commencement of the storm, upon receipt of the Environment Canada freezing rain warning. These contractors were available to provide assistance immediately as required. Further contractors were retained as required, consistent with the Emergency Preparedness Plan.

Halton Hills Hydro stated that it does not have official agreements with other LDCs regarding the provision of services in emergencies, although it regularly cooperates with a group of LDCs through Grid Smart City. As some of the Grid Smart City LDCs were also affected by the storm, Halton Hills Hydro contacted LDCs in other parts of the province to obtain assistance in the restoration effort.

Halton Hills Hydro stated that the labour rates invoiced from the external contractors and the LDCs were based on a combination of regular and premium rates. Board staff submits that this is not unreasonable, given the timing of the storm during a period of multiple statutory holidays and the use of average shift lengths of 16 hours.

Halton Hills Hydro stated that all costs are verifiable in the form of invoices from external parties and its own payroll register; however it did not describe its own efforts to verify the costs. While Board staff is concerned that there are limited details on how and if invoiced costs were verified by Halton Hills, Board staff appreciates that this was an emergency event and that normal procurement processes may be curtailed in order to focus on the safe and timely restoration of power.

Overall, Board staff submits that Halton Hills Hydro acted prudently in promptly securing assistance to restore power. However, Board staff notes that there appear to be some significant discrepancies in the summary of costs provided at page 10 of its evidence and the detail provided in response to Board staff interrogatories for external contractors and assisting utilities. Specifically, Halton Hills Hydro has provided total invoiced costs for external contractors of $497,102[2] and for assisting LDCs of $521,736[3], which is $228,367, or 18% less than the amounts of $868,936 and $378,269 claimed in its evidence and shown in Table 1, above.

Also, it is unclear to Board staff how the $49,682 in Other External Costs in Table 1 relates to the corresponding information provided in Halton Hills Hydro's responses to interrogatories. Further, the total amount requested in the application is $1,561,372, including carrying costs, while Halton Hills Hydro stated that the audited balance of the Account 1572 as at December 31, 2013 is $1,712,395[4].

Board staff requests that Halton Hills Hydro provide a reconciliation or correction to all of these amounts in its reply submission. In the absence of this reconciliation, staff submits that no determination of the precise claim, and, by extension, the associated prudence of Halton Hills Hydro's decisions in incurring these costs can be made.

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[2] Response to Board Staff Interrogatories, page 14
[3] Response to Board Staff Interrogatories, page 16
[4] Response to Board Staff Interrogatories, page 2

Cost Recovery Options

Board staff investigated in its interrogatories whether there were alternatives to recovering the cost of the storm damage from ratepayers.

In response to a question from staff about insurance coverage, Halton Hills Hydro indicated that, consistent with other LDCs in the province, it does not insure its distribution plant, and that no cost recovery through insurance claims is possible. Further, although Halton Hills Hydro considered the possibility of working with the municipality to obtain Ontario Disaster Relief Funding, it stated that this option was only available to municipal corporations, not Local Distribution Companies.

Board staff's interrogatories also sought the applicant's views regarding whether a distributor whose earnings exceed the Board-approved regulatory rate of return on equity should be able to bear the increased expenses that result from unforeseen events such as storm damage. In response to an interrogatory from Board staff[5] about its earnings levels, Halton Hills Hydro provided its revised achieved Return on Equity ("ROE") as follows:

	Board-Approved ROE	Reported ROE
2011	8.57%	9.14%
2012	9.12%	9.54%
2013	9.12%	14.05%

Halton Hills Hydro stated that the 2013 Regulated net income contained a one-time tax refund of $977,797, which was the result of accelerating certain expenses for tax purposes. Halton Hills Hydro also stated that the tax strategy results in a greater future tax liability in the form of lower CCA in later years.

Based on the reported ROE with the 2013 tax refund included, Board staff has calculated that Halton Hills Hydro has earned $1,144,881 in excess of the Board-approved level for 2013. Board staff further notes that correcting for the 2013 tax refund results in an actual ROE of 9.97%, which is still 85 basis points above Halton Hills Hydro's Board-approved level of 9.12%. Board staff requests that Halton Hills Hydro

[5] Board Staff Interrogatories, page 21

verify these calculations in its reply submission.

Furthermore, Board staff is unclear about the provenance of the 2013 tax refund and its consequences on other aspects of the utility's finances. Board staff was unable to find evidence in the financial statements of the nature of the one-time tax refund and future tax liability as described in Halton Hills' interrogatory response.

Board staff's review of Halton Hills Hydro's 2013 Financial Statements shows an increase in its regulatory account balances in 2013 of over $5 million. While these balances are carried forward for future recovery for regulatory purposes, this increase would be written off for tax purposes in the year of its occurrence. Board staff suggests that the 2013 tax refund may be partially explained by the increase in regulatory account balances.

In addition, Board staff notes that the extraordinary OM&A storm damage expenses of $1.5 million contained in this application would also be deducted for tax purposes in 2013, and would also have been a contributing factor in the 2013 tax refund.

It may be helpful to the Board if Halton Hills Hydro provides a description and breakdown of the factors leading to the 2013 tax refund in its reply submission, as well as an estimate of the future year CCA impacts and years affected. Without these clarifications, Board staff cannot assess whether the 2013 tax refund referred to by Halton Hills Hydro may at least be partially related to the storm damage OM&A expenses contained within this application. Clearly the additional OM&A expenses in 2013 would result in lower taxes payable.

Policy Considerations Regarding Z-factor Claims and Eligibility

Beyond these accounting-related matters, Board staff also wishes to raise a number of policy considerations which may provide guidance on an alternative approach to assessing the reasonableness of the total claim. In response to staff's question about excess returns being available to fund Z-factor claims, Halton Hills Hydro replied that recovery of Z-factor amounts is merely contingent on an LDC meeting the Board's three criteria of causation, materiality and prudence. In its view, no other factor, such as whether an LDC has earned more or less than anticipated, is relevant. It noted that the established regulatory regime places the extraordinary risk of Z-factor events on ratepayers.

Board staff acknowledges that the Board's Filing Requirements establish the eligibility for a Z-factor claim only on the basis of the three criteria noted above. However, Board staff submits that satisfying these criteria is a necessary condition but not necessarily the only factor to be considered. Staff further submits that the evaluation of a Z-factor claim – or, in fact, any application that has a bearing on rates -- always takes place within the regulatory context of just and reasonable ratemaking; accordingly, other factors, including earnings, reliability performance or any other relevant consideration can legitimately be included in the deliberation of whether the recovery of one-time costs from customers is in the public interest and in the interest of a utility's ratepayers in particular.

Board staff does not dispute that the current regulatory regime allows for the recovery of extraordinary Z-factor costs from ratepayers. However, in this instance, Board staff submits that the presence of earnings in excess of what the Board has established as a fair return – by a significant margin in 2013 and a persistent margin in the last 3 years - is a legitimate and appropriate consideration for the Board when evaluating whether a utility ought to recover the full amount of this extraordinary expense from its ratepayers.

Board staff also finds instructive a provision in the Renewed Regulatory Framework, dated October 18, 2012. It states the following:

> "One measure that will continue to be considered by the Board is annual earnings. The Board's policy in relation to the off-ramp, as set out in its July 14, 2008 EB-2007-0673 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, continues to be appropriate."

The Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors stated the policy as follows:

> "The Board has determined that the 3rd Generation IR plan will include a trigger mechanism with an annual ROE dead band of ±300 basis points. When a distributor performs outside of this earnings dead band, a regulatory review may be initiated. In support of this approach, a distributor will be required make a report to the Board no later than 60 days after the company's receipt of its annual

> audited financial statements, in the event that the distributor falls short of or exceeds its ROE by 300 basis points. The report will be reviewed to determine if further action by the Board is warranted. Any such review would be prospective and could result in modifications to the IR plan, a termination of the IR plan or the continuation of the IR plan."

In 2013, Halton Hills Hydro earned 493 (1405 less 912) basis points over the Board-approved ROE. Board staff submits that the level of earnings in 2013 by the applicant warrants evaluation whether the Price Cap IR plan for Halton Hills Hydro continues to balance properly the interests of customers in paying reasonable rates and the interest of the utility in earning a financial reward commensurate with its business risks. Given the level of overearnings, it may be appropriate for the Board to amend Halton Hills' rate setting plan, as contemplated by the policy, with respect to this Z-factor claim.

Board Staff accepts that there may be one-time adjustments that can result in a distributor exceeding the trigger mechanism for earnings in a given year. The nature of that adjustment should be a consideration in whether a modification of a rate-setting plan is appropriate. However, as noted above, there are limited details on Halton Hills Hydro's one-time tax adjustment to assess how it should be treated. Based on the information available at this time, Board staff submits that an appropriate modification of the plan would be to deny eligibility for the Z-factor claim for any amount above the earnings 300 basis-points above the Board-approved ROE, provided the Board is also satisfied that the claims are prudent, material and caused by the event and genuinely incremental to the base costs upon which rates have been set. Board staff has made a preliminary calculation based on available data and estimates the amount of earnings incremental to 300 basis points to be approximately $557,000. If the Board decides to adopt this approach, staff recommends that the Board order Halton Hills to calculate this precise amount as part of a draft rate order process.

Allocation of Costs and Rate Riders

Halton Hills Hydro has applied for fixed rate riders to recover the total amount of $1,561,372 including carrying costs over a two-year period commencing November 1, 2014. Rate riders have been calculated based on connections and metered customers as at December 31, 2013.

Board staff notes that past decisions of the Board[6] have ruled that approved costs should be allocated on the basis of distribution revenue, using the last approved fixed/variable split.

In response to Board staff interrogatories[7], Halton Hills Hydro indicated that it had allocated costs to the rate classes on the basis of distribution revenues, which assumes cost allocators by rate class. Halton Hills Hydro further noted that it had elected fixed rate riders as the costs associated with the restoration of power were not dependent on the customers' energy consumption.

Board staff submits that the use of fixed rate riders calculated on the basis of distribution revenue implicitly recognizes the appropriate allocation of costs and that a fixed rate rider is the fairest and simplest to administer.

Halton Hills Hydro has not applied to true-up the balance in the account following the disposition period, however in response to an interrogatory[8] it indicated a willingness to track the revenues received from the rate rider and refund any over collection to ratepayers.

Halton Hills Hydro provided forecast customer numbers to the end of the two-year recovery period, which show a forecast in residential customer growth over the period of 4%. Under these circumstances, the fixed rate riders calculated by Halton Hills Hydro could result in an amount of over-recovery of approximately $19,000. Board staff submits that the benefit of collecting this potential amount, which is below the materiality threshold, may be outweighed by the administrative difficulty involved.

Board staff notes that Halton Hills Hydro has provided actual customer numbers as at June 2014[9] and submits that the use of this more recent information may help to reduce the potential residual amount further.

Board staff submits that, should the Board decide that a true-up of the residual balance

[6] EB-2007-0515/0595/0571/0551
[7] Board Staff Interrogatories, page 24
[8] Response to Energy Probe Interrogatories, page 7

[9] Response to Energy Probe Interrogatories, page 7

is required following the recovery period, Halton Hills Hydro should provide a draft accounting order. This accounting order should demonstrate its proposed accounting treatment in the intervening period and the proposed future disposition of the residual balance in this account after the two-year recovery period expires.

Halton Hills Hydro has indicated that its proposed rate riders result in bill impacts to residential customer would be 1.62% and for GS <50kW customers, 1.43%. Board staff agrees that a recovery period of two years is appropriate to minimize bill impacts.

All of which is respectfully submitted